



**STATE INVESTMENT BOARD
BOARD ADOPTED POLICY**

POLICY NUMBER: 2.14.300

EFFECTIVE DATE: 3/20/03

TITLE: Daily Valued Funds Operations

SUPERSEDES: N/A

BOARD ADOPTION: 3/20/03

APPROVED: *Joseph A. Dea*

BACKGROUND:

The Washington State Investment Board (WSIB) has created commingled, daily valued funds (DVF's). The DVF's are offered as self-directed investment options.

PURPOSE:

This policy document sets forth the Board's responsibilities with respect to the operations of the daily valued funds. It articulates the structure; permitted scope of operation; delegated authorizations; and the policy ranges, tolerances and decision criteria for the accounting of the daily activities relating to the DVF's. Additional detailed, staff operating policies and procedures will be developed to supplement this policy.

DAILY VALUED FUNDS (DVF's):

The five daily valued funds are:

- Savings Pool
- Bond Fund
- Short Horizon Fund
- Mid Horizon Fund
- Long Horizon Fund

STRUCTURE AND OPERATING ENVIRONMENT:

WSIB

The WSIB is responsible for the investment and management of the DVF's, including investment policy-setting; fund structure; engaging external investment managers; portfolio rebalancing; trade processing; securities pricing of internally managed portfolios, i.e. the fixed income

portfolio; fund valuation and unitization; and determination of the unit value for each fund on a daily basis. The WSIB may contract with outside parties to perform certain of these functions.

Investors

The main investors in the DVFs are the participants in the deferred compensation program (DCP) and the defined contribution retirement plans. Both the DCP and the defined contribution retirement plans are managed by the Department of Retirement Systems (DRS). DRS contracts with a third party record keeper to perform the accounting at the participant level.

Other state agencies (investors) may invest in the DVFs as determined by WSIB's Chief Investment Officer.

External Managers

External managers on contract with the WSIB have delegated authority as fiduciaries to manage the investments.

Other Third Party Service Providers

External securities pricing services are used by the WSIB to assist in pricing underlying securities for the Bond Fund.

The WSIB uses an investment accounting service provider to perform various functions to permit the DVFs to be appropriately accounted, reported, valued, unitized, and priced. They serve as the book of record at the fund and portfolio level for each of the DVFs.

POLICY:

The daily valued funds are "institutional" products offered primarily as self-directed investment options to participants in defined contribution retirement plans and DCP, but are offered to other eligible trust funds. While the DVFs provide participants with the opportunity to obtain the value of their accounts and to trade and exchange investments on a daily basis, the DVFs are not mutual funds governed by the Investment Company Act of 1940.

This policy cannot foresee every potential situation governing the management and operations of the DVFs. Discretion is granted to staff to evaluate emergency situations, determine reasonable tolerances, and make required decisions to effectively manage and operate the funds.

This policy is not intended to identify and address all potential errors or problems. Rather, these guidelines will apply to many situations that may occur. Certain conditions or circumstances may require special actions that may vary from this policy and its procedures.

Transactions

1. Ownership of units in each DVF is maintained at the participating plan/fund level by the WSIB. The WSIB does not accept trade instructions at the individual member or participant level. The WSIB executes trade instructions received from the record keeper and trust funds for each DVF, detailing net purchases and sales by participating plan/fund.
2. In normal circumstances, transactions must be received, in good order from the record keeper and trust funds by the pre-established timeline to receive that business day's unit price for the applicable DVF. Trade instructions received later than that day's cutoff will be processed on the following business day at the unit price in effect on the close of that day. If timely instructions are received, purchases and sales of DVF units occur on a same day basis: pre-established timelines for processing participant transactions are such that all transactions received by cut-off times on Day 1 receive Day 1 closing prices even though the transactions settle on Day 2.
3. The WSIB DVFs will accept transactions on days that the New York Stock Exchange (NYSE) is open for trading, provided that all relevant parties and functions (including third-party relationships) are fully operational and the WSIB can determine a closing price for the day. On days that NYSE is closed, or all relevant parties and functions (including third party relationships) are not fully operational, all daily valued fund transactions are held and processed the next business day when the markets reopen, or the parties or functions are fully operational, and receive the next current unit price.

Efforts will be made to minimize errors. The following controls have been established to ensure WSIB's operating processes result in accurate unit prices: automation has been used to reduce manual data entry, unitization and unit pricing worksheets as well as all activity and investment trade tickets receive supervisor review prior to release, and a business continuance plan has been prepared to ensure activity will not be suspended. However, it is reasonable to assume that errors will occur despite efforts to guard against them. Upon identification of an error, WSIB staff will determine how to remedy the error in conformity with the Error Resolution section of this policy document.

Valuation, Unitization and Pricing

1. DVF unit values are processed and recorded in the investment accounting system.
2. Savings Pool – Guaranteed Insurance Contracts (GICs) are the securities that primarily make up the Savings Pool. The amount invested in the GICs, plus any interest accrued to date, is used in the calculation of the daily unit value for the fund. If the credit rating of the issuer of the GIC declines to an extent that the value of the GIC is affected, the WSIB will engage a third party to establish the fair market value of the GIC.
3. Bond Fund - External pricing services are used to assist in pricing underlying securities in the Bond Fund. The WSIB will maintain a secondary pricing service for tolerance and

variance checks and to serve as a back-up in the event of service interruptions with the primary pricing service. The WSIB and investment accounting service provider shall mutually agree on selection of the pricing services used. They will follow operating policies agreed upon with WSIB in the event that pricing is outside permitted tolerances and/or in the event of a failure of the primary pricing service to meet timelines.

4. Horizon Funds – Prices for equity index funds and the interest rate factor for cash as determined by the external managers) are received each business day by the WSIB according to pre-established timelines. The closing unit price for the Bond Fund component of the Horizon Funds is determined by the investment accounting service provider and adopted by the WSIB pursuant to the procedure described above.
5. The closing unit prices for each DVF are communicated by the WSIB to the record keepers by the pre-established timelines, so that the record keepers can record the transactions, values, units and allocated expenses, if applicable, to the participants' accounts.
6. Valuation and pricing errors, incorrect values/prices submitted by WSIB's external managers or third parties, etc. will be corrected as soon as is feasible upon their detection or receipt of notice of such error by WSIB, and, whenever possible, before finalizing the closing unit price for the DVFs on the date of the error.
7. The funds will be priced when the NYSE is open, unless there are emergency circumstances as determined by the US Securities and Exchange Commission.

Policy and Materiality Tolerances

1. Closing unit pricing errors: Errors that amount to less than \$0.01 (one cent) per unit value for the specific fund will be considered immaterial and will be corrected in the next day's pricing. No external parties need to be notified. Errors equal to or greater than one cent (\$0.01) per unit value for the specific fund shall be considered material and shall be communicated to the record keeper and DRS at the time the error is discovered. The WSIB will discuss with the record keeper and DRS the best way to rectify the situation.
2. Any closing unit pricing error shall be promptly communicated to the Deputy Director of Operations (DDO) or designated back-up. Errors greater than the tolerance level, regardless of their source, shall also be communicated to the executive director, and reported to the Board. Once a year, all errors below the tolerance level, regardless of their source, will be reported to the Audit Committee.
3. Inability to Close:
 - a. If trade processing, valuing, unitization, or pricing problems occur, closing prices from external managers are delayed, errors are detected, or other problems or disruptions occur (regardless of whether the problem is attributed to the WSIB or

to external parties) and it appears the closing unit prices cannot be completed by normal timelines, WSIB will notify the record keeper to coordinate a delayed closing. If this is acceptable to the record keeper, WSIB staff will remain on duty to complete the DVFs process as normal. However, if the problem is specific to the WSIB fund(s), DRS will be notified of the situation and coordinate a delayed closing with the record keeper and inform WSIB of the outcome.

- b. If a delayed closing timeline is not acceptable to the record keeper, DRS will be immediately notified. The participant transactions will be suspended in an industry-wide event that results in the suspension of trading on the NYSE. They will be processed using the next business day's closing unit price. However, if the problem is specific to the WSIB, then the prior day prices will be adjusted by the following indexes: for the Bond Fund – Lehman Credit Index, for the Horizon Funds: domestic equities (currently Barclay's Global Investment) – Wilshire 5000, non-US equities (currently State Street Global Advisors) – EAFE index, and cash – 1 month Libor. The Asset Allocation Officer will give the index(es) to the Portfolio Administration unit, who will calculate the adjustment.
4. The DDO or designated back-up shall be alerted of potential closing problems. The record keeper and the investment accounting service provider will also be notified of these situations.

Error Resolution:

1. Documented losses that occur as a result of failure or errors by a WSIB external entity or third-party will be reviewed by the WSIB and a claim may be submitted if it is cost effective to do so. Anticipated reimbursement for losses should be accounted for in accordance with appropriate accounting standards applicable to the DVFs. No claim against a third party is required for losses below the materiality policy tolerances for errors. In accordance with "Policy and Materiality Tolerances", paragraph 1, the record keeper shall be informed of any material valuation error. The record keeper shall determine the impact on participant accounts and communicate the impact to the WSIB and DRS.
2. Errors below the tolerance level will be self-corrected through the next available unit pricing and, if so determined by WSIB, other appropriate action may be taken.

Expenses and Costs

The costs of the DVFs are to be borne by the participants. Expenses allocated to the DVFs shall reflect direct services and/or the incremental costs associated with the investment and management of the fund(s). All expenses and costs are either allocated to the Fund and calculated in the unit price established by the WSIB/record keeper, or assessed by the record keeper to applicable participant accounts to cover the costs. Costs associated with the DVFs are accrued on a daily basis and reflected in the daily unit values to the extent practical.

Business Readiness

1. The WSIB will take reasonable action to implement back-up systems and business continuance plans for the management and operation of the DVFs in the event of widespread power outages, fires, natural disasters, terrorist acts, emergencies, and other events beyond the control of the WSIB. The WSIB reserves the option to temporarily suspend all transactions for any or all daily valued funds due to uncontrollable events such as those listed above, market disruptions, localized or national emergencies, or other significant events that would make such a suspension necessary.
2. The executive director (or designated executive back-up) is authorized to suspend transactions if necessary. Suspension of transactions will be by official notification to relevant parties, including the Chair and/or Vice Chair of the Board, DRS, the record keepers, external managers, the custodian bank, investment accounting service provider, and announcements on the WSIB website.